HON. RON PAUL OF TEXAS BEFORE THE US HOUSE OF REPRESENTATIVES July 8, 2004

Government Spending- A Tax on the Middle Class

All government spending represents a tax. The inflation tax, while largely ignored, hurts middle-class and low-income Americans the most.

The never-ending political squabble in Congress over taxing the rich, helping the poor, “Pay-Go,” deficits, and special interests, ignores the most insidious of all taxes- the inflation tax. Simply put, printing money to pay for federal spending dilutes the value of the dollar, which causes higher prices for goods and services. Inflation may be an indirect tax, but it is very real- the individuals who suffer most from cost of living increases certainly pay a “tax.”

Unfortunately no one in Washington, especially those who defend the poor and the middle class, cares about this subject. Instead, all we hear is that tax cuts for the rich are the source of every economic ill in the country. Anyone truly concerned about the middle class suffering from falling real wages, under-employment, a rising cost of living, and a decreasing standard of living should pay a lot more attention to monetary policy. Federal spending, deficits, and Federal Reserve mischief hurt the poor while transferring wealth to the already rich. This is the real problem, and raising taxes on those who produce wealth will only make conditions worse.

This neglect of monetary policy may be out of ignorance, but it may well be deliberate. Fully recognizing the harm caused by printing money to cover budget deficits might create public pressure to restrain spending- something the two parties don’t want.

Expanding entitlements is now an accepted prerogative of both parties. Foreign wars and nation building are accepted as foreign policy by both parties.

The Left hardly deserves credit when complaining about Republican deficits. Likewise, we’ve been told by the Vice President that Ronald Reagan “proved deficits don’t matter”- a tenet of supply-side economics. With this the prevailing wisdom in Washington, no one should be surprised that spending and deficits are skyrocketing. The vocal concerns expressed about huge deficits coming from big spenders on both sides are nothing more than political grandstanding. If Members feel so strongly about spending, Congress simply could do what it ought to do- cut spending. That, however, is never seriously considered by either side.

If those who say they want to increase taxes to reduce the deficit got their way, who would benefit? No one! There’s no historic evidence to show that taxing productive Americans to support both the rich and poor welfare beneficiaries helps the middle class, produces jobs, or stimulates the economy. Borrowing money to cut the deficit is only marginally better than raising taxes. It may delay the pain for a while, but the cost of government eventually must be paid. Federal borrowing means the cost of interest is added, shifting the burden to a different group than those who benefited and possibly even to another generation. Eventually borrowing is always paid for through taxation.

All spending ultimately must be a tax, even when direct taxes and direct borrowing are avoided. The third option is for the Federal Reserve to create credit to pay the bills Congress runs up. Nobody objects, and most Members hope that deficits don’t really matter if the Fed accommodates Congress by creating more money. Besides, interest payments to the Fed are lower than they would be if funds were borrowed from the public, and payments can be delayed indefinitely merely by creating more credit out of thin air to buy U.S. treasuries. No need to soak the rich. A good deal, it seems, for everyone. But is it?

Paying for government spending with Federal Reserve credit, instead of taxing or borrowing from the public, is anything but a good deal for everyone. In fact it is the most sinister seductive “tax” of them all. Initially it is unfair to some, but dangerous to everyone in the end. It is especially harmful to the middle class, including lower-income working people who are thought not to be paying taxes. The “tax” is paid when prices rise as the result of a depreciating dollar. Savers and those living on fixed or low incomes are hardest hit as the cost of living rises. Low and middle incomes families suffer the most as they struggle to make ends meet while wealth is literally transferred from the middle class to the wealthy. Government officials stick to their claim that no significant inflation exists, even as certain necessary costs are skyrocketing and incomes are stagnating. The transfer of wealth comes as savers and fixed income families lose purchasing power, large banks benefit, and corporations receive plush contracts from the government- as is the case with military contractors. These companies use the newly printed money before it circulates, while the middle class is forced to accept it at face value later on. This becomes a huge hidden tax on the middle class, many of whom never object to government spending in hopes that the political promises will be fulfilled and they will receive some of the goodies. But surprise- it doesn’t happen. The result instead is higher prices for prescription drugs, energy, and other necessities. The freebies never come. The Fed is solely responsible for inflation by creating money out of thin air. It does so either to monetize federal debt, or in the process of economic planning through interest rate manipulation. This Fed intervention in our economy, though rarely even acknowledged by Congress, is more destructive than Members can imagine.

Not only is the Fed directly responsible for inflation and economic downturns, it causes artificially low interest rates that serve the interests of big borrowers, speculators, and banks. This unfairly steals income from frugal retirees who chose to save and place their funds in interest bearing instruments like CDs.

The Fed's great power over the money supply, interest rates, the business cycle, unemployment, and inflation is wielded with essentially no Congressional oversight or understanding. The process of inflating our currency to pay for government debt indeed imposes a tax without legislative authority.

This is no small matter. In just the first 24 weeks of this year the M3 money supply increased 428 billion dollars, and 700 billion dollars in the past year. M3 currently is rising at a rate of 10.5%. In the last seven years the money supply has increased 80%, as M3 has soared 4.1 trillion dollars. This bizarre system of paper money worldwide has allowed serious international imbalances to develop. We owe just four Asian countries 1.5 trillion dollars as a consequence of a chronic and staggering current account deficit now exceeding 5% of our GDP. This current account deficit means Americans must borrow 1.6 billion dollars per day from overseas just to finance this deficit. This imbalance, which until now has permitted us to live beyond our means, eventually will give us higher consumer prices, a lower standard of living, higher interest rates, and renewed inflation.

Rest assured the middle class will suffer disproportionately from this process. The moral of the story is that spending is always a tax. The inflation tax, though hidden, only makes things worse. Taxing, borrowing, and inflating to satisfy wealth transfers from the middle class to the rich in an effort to pay for profligate government spending, can never make a nation wealthier. But it certainly can make it poorer.